

AUDITOR'S REPORT OF THE AUDITOR-GENERAL TO THE FREE STATE LEGISLATURE AND THE COUNCIL OF THE NALEDI LOCAL MUNICIPALITY ON NALEDI LOCAL MUNICIPALITY

REPORT ON THE FINANCIAL STATEMENTS

Introduction

- 1 I was engaged to audit the accompanying financial statements of the Naledi Local Municipality, which comprise the statement of financial position as at 30 June 2010, the statement of financial performance, statement of changes in net assets and cash flow statement for the year then ended, a summary of significant accounting policies and other explanatory information and the accounting officer's report, as set out on pages ... to

Accounting officer's responsibility for the financial statements

- 2 The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and in the manner required by the Local Government: Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2009 (Act No. 12 of 2009) (DoRA). This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor-General's responsibility

- 3 As required by section 188 of the Constitution of South Africa, 1996 (Act No. 108 of 1996), section 4 of the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA) and section 126(3) of the MFMA, my responsibility is to express an opinion on the financial statements based on conducting the audit in accordance with the International Standards on Auditing and *General Notice 1570 of 2009* issued in *Government Gazette 32758 of 27 November 2009*. Because of the matters described in the basis for disclaimer of opinion paragraphs, however, I was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis for disclaimer of opinion

Property, plant and equipment

- 4 For reasons as detailed below, I was unable to obtain sufficient appropriate audit evidence as to the existence, completeness, classification and valuation of, and rights to ownership of property, plant and equipment amounting to R34 452 387 (2009: R34 320 410), as disclosed in the statement of financial position and note 5 to the financial statements.
 - (a) Investment property was not disclosed in the financial statements, although the municipality had property that met the definition of investment property in accordance with the SA Standards of GRAP, GRAP 16 *Investment Property*. Due

to the lack of properly maintained asset register, which detailed the location, amount and classification of properties between owner-occupied and investment properties, I was thus unable to perform all the audit procedures that I considered necessary to confirm that property, plant and equipment had been appropriately classified in the financial statements. Since the asset register was not properly maintained, I could not determine the understatement of property, plant and equipment, and the municipality's records did not permit the application of alternative audit procedures.

- (b) Several assets amounting to R32 157 723 could not be traced back to the asset register, owing to unclear descriptions and/or insufficient detail with regard to the location or unique identification of the specific asset.
- (c) Supporting documentation, and explanation from management could not be obtained for the additions and write off of property, plant and equipment amounting to R79 344 401 for the year under review.
- (d) Insufficient supporting documentation was obtained relating to transfers of property, plant and equipment amounting to R189 005.
- (e) Several assets amounting to R2 408 722 could not be physically verified. This was due to unclear descriptions and/or insufficient detail with regard to the location of the specific asset.
- (f) Supporting documentation relating to finance lease and electricity connections (R321 505) could not be submitted for audit purposes. Furthermore, no alternative audit procedures could be performed.

5 Due to the extent of the weaknesses in the municipality's fixed asset records, the lack of sufficient appropriate supporting documentation and the reliance that could not be placed on the internal verification of assets, I could not perform reasonable alternative procedures to obtain all the documentation and explanations deemed necessary.

Inventory

6 I was unable to obtain sufficient appropriate audit evidence as to the existence, completeness, classification and valuation of, and rights to ownership of inventory amounting to R1 013 934, as disclosed in the statement of financial position and note 11 to the financial statements, as a result of non-submission of supporting documentation. The municipality's records did not permit the application of alternative audit procedures.

Consumer receivables and other receivables

7 I was unable to obtain sufficient appropriate audit evidence as to the existence, completeness, classification and valuation of, and rights to ownership of consumable receivables and other receivables amounting to R40 516 930, as disclosed in the statement of financial position and notes 2 and 3 to the financial statements, due to the following:

Long-term loan

- 9 Supporting documentation relating to the loan agreement of R764 971 could not be obtained, consequently the valuation, occurrence, completeness and obligation of the outstanding amount, as disclosed in note 13 to the financial statements, could not be confirmed.
- 10 Finance lease obligation has not been disclosed and due to lack of supporting documentation, the amount could not be quantified.

Revenue

- 11 As a result of the matters detailed below, I was unable to obtain sufficient appropriate audit evidence as to the completeness, accuracy, occurrence and classification of revenue, as disclosed in the statement of financial performance amounting to R44 856 477 (2009: R63 016 554).
 - (a) Included in the amount of other income/general income, as disclosed in service income, are expenditure transactions which were incorrectly allocated and set-off against income, resulting in understatement of revenue and expenditure by an amount of R1 834 061.
 - (b) The monthly billing transaction charged for water usage was not updated in the general ledger, resulting in service income and consumer deposits understated by R546 040.
 - (c) An unexplained difference between the general ledger and the amount appropriated in terms of DoRA, to the amount of R11 506 374, was identified. Consequently, I could not be provided with all the necessary explanations to confirm the completeness of grant funds received. The municipality's records did not permit the application of alternative audit procedures.
 - (d) The water meter reading amounting to R1 861 467, could not be confirmed due to information relating to water reading charged to consumers which could not be submitted.
 - (e) The water meter readings do not agree with the readings recorded in the meter reading book, this had resulted in a misstatement of R14 275 202 which could not be confirmed.
 - (f) Supporting documentation relating to rotating meters installed, amounting to R4 258 398 (2009: R2 536 973), were not provided.
 - (g) Supporting documentation relating to pre-paid electricity and other income amounting to R6 927 094, were not provided.
 - (h) An unexplained difference of R292 507 between grants received and supporting documentation was identified resulting in understatement of grants income and other receivables.

- (i) Significant change in other income could not be confirmed due to comparative figures that were not disclosed in the financial statement, as required by GRAP 1 that requires comparative figures to be disclosed.
- (j) Sale of water amounting to R4 287 590 was incorrectly classified under bulk purchases, resulting in understatement of service charges and bulk purchases.
- (k) Operating lease income amounting to R244 833 was not disclosed in the annual financial statement according to paragraph 75 of GRAP 13 that requires the disclosure of future minimum lease payments.

Expenditure

- 12 For the reasons as detailed below, I was unable to obtain sufficient appropriate audit evidence as to the occurrence, completeness and accuracy of expenditure of R45 723 781 (2009: R52 468 721), as disclosed in the statement of financial performance.
 - (a) I was unable to obtain supporting documents for the delivery of goods amounting to R4 908 911, as a result sufficient appropriate audit evidence could not be obtained as to completeness, measurement, occurrence and accuracy of amount as stated. The municipality's records did not permit alternative procedures to be performed.
 - (b) Supporting documentation relating to the journal amounting to R446 208 could not be submitted for audit purpose. Furthermore, the journal was not authorised by the delegated official.
 - (c) The electrical service provider's distribution loss amounting to R643 063 was calculated using the incorrect amounts and was not disclosed separately, resulting in understatement of general expenditure and inventory.
- 13 Tender documentation and approved minutes of a meeting for tenders and related quotations for an amount of R 12 536 543 could not be submitted for audit purposes. Consequently, I could not establish whether tender regulations in awarding the tenders were followed or quotations were invited in accordance with supply chain management regulations. The municipality's records did not permit the application of alternative audit procedures.

Unspent conditional grants and receipts

- 14 The expenditure relating to conditional grant was not transferred from unspent conditional grant to revenue and expenditure account, as a result sufficient appropriate audit evidence could not be obtained as to completeness, occurrence and accuracy of R5 446 124. This resulted in overstatement of unspent conditional grant and understatement of revenue. The municipality's records did not permit the application of alternative audit procedures.

15 Unexplained difference of R9 001 132 between general ledger and supporting documentation was established, resulting in overstatement of unspent conditional grant.

Employee-related costs

16 The difference between the overtime worked and overtime paid was identified to the amount of R486 955. Sufficient appropriate audit evidence could not be obtained as to the completeness, occurrence and accuracy of the amount for overtime to the amount of R 486 955 as included in employee related costs. The municipality's records did not permit the application of alternative audit procedures.

17 A difference between the total amount of employee-related costs, as disclosed in the statement of financial performance; and the total of employee-related cost in the monthly payroll reconciliation to the amount of R797 441 was identified. Management could not provide me with all the necessary explanations for the differences. Due to lack of sufficient appropriate audit evidence, I could not confirm the completeness, accuracy and occurrence of the amount disclosed in the financial statements. The municipality's records did not permit the application of alternative audit procedures.

18 I could not physically verify existence of all the employees for audit purposes.

19 Quantitative information in respect of employee benefits for post employment benefits was not disclosed in the notes to the financial statements, consequently contributions made for retirement benefits were also not disclosed as required by IAS 19.

20 The amount disclosed for remuneration of councillors in note 19 to the financial statements does not agree with the amount disclosed in the statement of financial performance. Consequently, the amount in the statement of financial performance was understated by an amount of R751 233.

Value added tax

21 In numerous instances, VAT invoices could not be provided, as result it could not be confirmed whether the municipality complied with all the provisions of the VAT act when completing the VAT returns and whether the VAT receivable, as disclosed in note 3 to the financial statements, to the amount of R5 525 234 is fairly stated.

22 Several invalid tax invoices were noted which resulted in input VAT to the amount of R505 512 incorrectly claimed. This is as a result of a lack of internal controls in validating the validity of tax invoices prior effecting payment by the municipal officials.

Cash and cash equivalents

23 A difference between cash balance of R1 384 808, as per reconciliation and the general ledger, was established. Management could not provide me with all the necessary explanations for the difference. Due to lack of sufficient appropriate audit evidence, I could not confirm the completeness, occurrence and accuracy of the overdrawn amount as disclosed in the statement of financial position to the amount of R1 263 847. The municipality's records did permit the application of alternative audit procedures.

- 24 I was unable to obtain supporting documentation for bank overdraft of R1 263 847, as disclosed on in note 33 to the annual financial statement, as a result cash and cash equivalents were materially overstated.
- 25 The direct deposit amounting to R912 951 was not recorded in the correct accounting period resulting in understatement of cash and cash equivalents.

Provisions

- 26 No supporting documentation could be provided to confirm that leave days of employees are captured on the SAMRAS systems, therefore accrued expense of R1 120 126, could not be verified.

Capital commitments

- 27 I was unable to obtain supporting documentation for a capital commitment of R30 536 926, as disclosed in note 22 to the annual financial statement, as a result I could not confirm the occurrence, obligations, classification, completeness and accuracy of the amount disclosed. The municipality's records did not permit the application of alternative audit procedures.

Contingent liabilities

- 28 I was unable to obtain supporting documentation in respect of the contingent liabilities, as disclosed in note 25 to the financials statement, as a result I could not confirm the occurrence, classification, accuracy, completeness, valuation, obligation and existence of the amount disclosed. The municipality's records did not permit the application of alternative audit procedures.

Unauthorised, irregular and wasteful expenditure

- 29 The comparative figures relating to the prior year were not disclosed in the current year's financial statements. Consequently, the comparative figures in respect of irregular expenditure and fruitless and wasteful expenditure are understated by R294 000 and R10 954 554, respectively.
- 30 Irregular expenditure and unauthorised expenditure to the amount of R537 924 was not identified by management and disclosed in the financial statements. This expenditure relates to the following:
 - (a) No approval was granted for expenditure of R433 407
 - (b) Expenditure transactions to the amount of R104 516 were not authorised by a delegated official.

Presentation and disclosures

31 The electrical service provider's figures were not included in the municipality's financial statement in the prior year. These figures were, however, correctly included in the comparative figures of the current year's financial statement. The adjustment made to the comparative figures was incorrectly disclosed as a change in the accounting policy. This is contrary to the requirements of GRAP 3 that this to be disclosed as a prior period error.

Disclaimer of opinion

32 Because of the significance of the matters described in the basis for disclaimer of opinion paragraphs, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, I do not express an opinion on the financial statements.

Emphasis of matters

I draw attention to the matter below. My opinion is not modified in respect of this matter.

Significant uncertainties

33 While the municipality has prepared its financial statements on a going concern basis, there are a number of indicators that the municipality is experiencing financial difficulties, as disclosed in note 42 to the financial statements. The municipality overspent on the conditional grants by R7 408 060 whilst its short-term investments only amount to R124 374. The current liabilities of the municipality exceed its current assets.

Restatement of corresponding figures

34. As disclosed in note 23.5 to the financial statements, the corresponding figures have been restated as a result of an error discovered in the prior year to account for the surplus or deficit from the electrical service provider.

Additional matters

I draw attention to the matters below. My opinion is not modified in respect of these matters.

Material inconsistencies in other information included in the annual report

35. I was unable to determine if any material inconsistencies exist between the financial statements and other information to be included in the annual report, as management could not provide me with the report in respect of the year under review

Unaudited supplementary schedules

36. The supplementary information set out on pages xx to xx does not form part of the financial statements and is presented as additional information. I have not audited these schedules and accordingly I do not express an opinion thereon.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

As required by the PAA and in terms of *General Notice 1570 of 2009* issued in *Government Gazette 32758 of 27 November 2009*, I include below my findings on the report on predetermined objectives, compliance with the MFMA, DoRA, Local Government: Municipal Systems Act of South Africa, 2000 (Act No. 32 of 2000) (MSA), Municipal Supply Chain Management Regulations of South Africa (GNR.868 of 30 May 2005) (SCM regulations), Local Government: Municipal Planning and Performance Management Regulations of South Africa, 2001 (GNR.796 of 24 August 2001), and financial management (internal control).

Predetermined objectives

Non-compliance with regulatory and reporting requirements

Reported performance information not received in time

37. The reliability of the performance information as set out on pages XX to XX of the annual report could not be verified because the information was not received on time.

Internal auditing of performance measurements

38. The internal audit section did not audit the performance measurements on a continuous basis and did not submit quarterly reports on their audits as required by section 45 of the MSA.

Lack of adoption or implementation of a performance management system

39. The municipality did not adopt and implement a framework that described and represented how the municipality's cycle and processes of performance planning, monitoring, measurement, review, reporting and improvement would be conducted, organised and managed, including determining the roles of the different role players, as required in terms of sections 36, 38 and 41(2) of the MSA, and regulations 7 and 8 of the Municipal Planning and Performance Management Regulations, 2001.

No mid-year budget and performance assessments

40. The accounting officer of the municipality did not (by 25 January of each year) assess the performance of the municipality during the first half of the financial year, taking into account the municipality's service delivery performance during the first half of the financial year and the service delivery targets and performance indicators set in the service delivery and budget implementation plan, as required by section 72 of the MFMA.

Compliance with laws and regulations

Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA)

41. Contrary to section 166 of the MFMA, the municipality did not have a functioning audit committee for the year under review.
42. Contrary to the requirements set out in section 165(1) of the MFMA, the municipality's internal audit section was not functional during the financial year.
43. Contrary to the requirements set out in section 131 (2) of the MFMA, the municipality did not table the prior year annual report.
44. Contrary to the requirements set out in section 79 (3)(a) of the MFMA and section 59 of the MSA, the municipality could not submit written proof about the delegation of powers.
45. Contrary to the requirements set out in section 57 of the MFMA, the municipality did not enter into performance contracts with section 57 managers.
46. Contrary to section 64 of the MFMA, the accounting officer did not inform the National Treasury of any payments due by an organ of state to the municipality in respect of municipal tax or for municipal services, if such payments are regularly in arrears for periods of more than 30 days.
47. Contrary to section 65(2)(e) of the MFMA the accounting officer did not ensure that payments to suppliers were made within 30 days after receiving the invoice.
48. Contrary to section 62 of the MFMA, the accounting officer did not take reasonable steps to ensure that the financial administration is managed.
49. Contrary to section 64 (1-2) of the MFMA, the accounting officer did not adhere to his responsibilities regarding revenue management.
50. Contrary to section 75 of the MFMA, the accounting officer of the municipality did not ensure that documents are placed on the website as referred to in section 21A of the Municipal Systems Act.
51. Contrary to section 53 of the MFMA, the mayor did not ensure that the municipality provides guidance regarding budget processes and related matters, did not perform budgetary control and early identification of financial problems.
52. Contrary to section 69(1) of the MFMA, the accounting officer did not take reasonable steps during the budget implementation process, did not publish the annual budget and did not submit an approved budget to the National Treasury and the relevant provincial Treasury.

Local Government: Municipal Property Rates Act, 2004 (Act No. 6 of 2004)

53. Contrary to the requirements set out in section 15 of the Property Rates Act, the municipality did not exempt a specific category of owners of property from payment of a rate levied on their property as required by this act.

54 Contrary to the requirements set out in section 7 of the Property Rates Act, the municipality did not levy rates on all the rateable property as required by this section.

Local Government: Municipal Structures Act, 1998 (Act No. 117 of 1998)

55. Contrary to the requirements set out in section 18 of the MSA, the council of the municipality did not meet at least quarterly as required by this act.

Local Government: Municipal Systems Act, 2000 (Act No. 32 of 2000)

56. Contrary to the requirements set out in section 70 of the MSA, the municipality did not ensure that the code of conduct was communicated to the employees.

57. Contrary to the requirements set out in section 74 of the MSA, the municipality did not adopt and implement a tariff policy for levying property rates for services provided by the municipality as required by this section.

58. Contrary to section 68(1) of the MSA, the municipality did not develop its human resource capacity to a level that enables it to perform its functions and exercise its powers in an economical, effective, efficient and accountable way.

59. Contrary to section 18(1) of the MSA, the municipality did not communicate information regarding community participation or promote the rights and duties of the members of the local community.

Internal control

60. I considered internal control relevant to my audit of the financial statements and the report on predetermined objectives as well as compliance with the MFMA, MSA and DoRA, but not for the purposes of expressing an opinion on the effectiveness of internal control.

61. The matters reported below are limited to the significant deficiencies regarding the basis for disclaimer of opinion paragraphs, the findings on the report on predetermined objectives and the findings on compliance with laws and regulations.

Leadership

62. The accounting officer did not prioritise and take appropriate action to address the lack of discipline in the finance and supply chain management directorates, resulting in non-compliance with applicable legislation and inadequate budget control measures. This, in turn, resulted in irregular, fruitless and wasteful as well as unauthorised expenditure.

63. The posts of the directors of Community Services and of Corporate Services, the technical manager and the chief financial officer were vacant for extended periods, resulting in a lack of oversight.

64 Significant difficulties were experienced concerning delays or the availability of requested information due to management's dependence on a third party in providing the requested information.

Financial and performance management

65 The position of chief financial officer was vacant for 11 months of the financial year. The acting chief financial officer did not sufficiently monitor the recording and reconciliation of financial records. Sufficient control measures were also not developed to address all the qualifications reported in the prior years.

66 The financial statements were subject to material corrections resulting from the audit process, which were attributable to no risk assessment being performed, weaknesses in the design and implementation of internal control in respect of financial management and financial reporting, and weaknesses in the information systems of the municipality.

67 The work of the third party that completed the financial statements was not reviewed for completeness and accuracy prior to submission for auditing.

68 Management did not ensure that general information technology controls were designed to maintain the integrity of the information system and the security of data.

69 Management did not document and approve internal policies and procedures to address the process of collection, recording, processing, monitoring and reporting on performance information, as adequate performance management systems had not been implemented.

Governance

- 70 The municipality did not perform or implement a risk assessment and a risk management strategy for the financial year.
- 71 No audit committee was functioning during the current financial year, which could have advised the council on matters relating to internal financial control and internal audits, as internal audit work was not performed according to the audit plan.
- 72 No evidence could be obtained that the audit committee had responded to the council on issues raised by the auditor-general.

Auditor-General

Bloemfontein

31 March 2011



AUDITOR-GENERAL
SOUTH AFRICA

Auditing to build public confidence